TEACHERS' RETIREMENT BOARD

BENEFITS AND SERVICES COMMITTEE

SUBJECT: CalSTRS Role in Health Care ITEM NUMBER: 7

ATTACHMENT(S): 1

ACTION: ____ MEETING DATE: May 7, 2003

INFORMATION: X PRESENTER: Ed Derman

BACKGROUND

Staff was directed to evaluate alternative roles for the California State Teachers' Retirement System (CalSTRS) to play with respect to the health care benefits provided to CalSTRS members.

Current Status of Health Care for CalSTRS Members

Currently, the provision of health insurance is an issue of collective bargaining that is addressed at the local level. California school employers secure health insurance through a variety of different vehicles. Approximately 120 school districts contract with the California Public Employees' Retirement System (CalPERS) to obtain the health care coverage for their employees. Other districts join together to form trusts (with their employees) or joint power agencies to purchase health insurance as a large block. The Southern California Voluntary Employees Benefit Association and the Central Valley Schools Health and Welfare Trust are two examples of trusts that provide health benefits. According to the California Teachers' Association, there are 11 trusts with 265 participating districts that provide health coverage for 365,000 individuals. Self-Insured Schools of California is a joint powers entity administered by the Kern County Office of Education that provides health benefits to 266 school agencies in 31 counties. There also are districts that individually purchase their own health insurance.

Attachment 1 summarizes the present state of health care costs in the United States.

Health Benefits for Retired Members

The availability and cost of health benefits to retired educators varies widely throughout the state. Districts are required to permit retired employees to purchase health insurance, at the employee's own cost. These are often called AB 285 benefits, a reference to the bill that was enacted in 1985 to require such benefits. In many districts, this is the only health benefit made available to retired employees. In addition, most districts require that employees take this benefit immediately upon retirement, or else the employee loses eligibility. At the other extreme, some districts contribute toward the cost of health insurance throughout the remaining lifetime of the retired employee. Finally, many districts fund health benefit costs until the retired employee reaches age 65, when Medicare eligibility begins. Those districts that contract with CalPERS for

health benefits are required by state law to contribute toward their retired employee's health benefit costs.

CalSTRS is conducting a health benefit survey of school districts to determine the pressures the districts are facing in providing health benefits to their active and retired employees. Staff will report the results of that survey to the Board later this year.

CalSTRS Current Role in Health Benefits

CalSTRS plays no role in the health benefits provided to active CalSTRS members; that is the responsibility of the local employer. CalSTRS does, however, participate in the provision of health benefits for retired members in two ways. First, CalSTRS administers the Medicare Premium Payment (MPP) Program. Under the MPP Program, CalSTRS pays the Medicare Part A premium for eligible retired Defined Benefit Program members who do not otherwise qualify for Part A coverage without payment of a premium. In addition, CalSTRS will deduct the premiums for health benefits, including Medicare Part B, from a member's allowance at the request of the member, and forwards that premium to the health benefit provider. In this latter activity, CalSTRS provides a service to the member, but does not have contracts with the carriers, or negotiate coverage provisions or rates.

The role that teacher retirement systems play in the health care coverage for retired educators varies throughout the country. At the Committee meeting, staff will provide a summary of the 2001 Health Care Survey conducted by the National Council on Teacher Retirement.

DISCUSSION

Since 1998, the Teachers' Retirement Board has evaluated a number of different approaches that it could take to improve the health security of CalSTRS members. Essentially, there are three roles that CalSTRS could play with respect to member's health care: it could serve as a provider of health care, a financier of health care or an advisor on health care matters. This item discusses the implications of each of these approaches.

Provider of Health Benefits

If CalSTRS became a provider of health benefits, it would contract with carriers and negotiate for benefits including plan design and rates. This is comparable to the role currently played by CalPERS. Presently, CalPERS is the health insurance provider for state employees, approximately 120 school districts, and numerous municipalities and local agencies. It also administers plans for the California Association of Highway Patrolmen and the Peace Officers Research Association of California. It presently contracts with Kaiser, Blue Shield and Western Health Advantage for Health Maintenance Organization (HMO) coverage and also offers two Preferred Provider Organization (PPO) Plans. It contracts with Blue Cross to administer the PPOs and has a separate pharmacy benefits administrator to manage the prescription drug program for the PPOs.

CalPERS is the third largest purchaser of health benefits in the United States, behind the federal government and General Motors. In the past, CalPERS' size has enabled it to exercise

considerable leverage in the marketplace to control its costs. Lately, however, CalPERS has lost a lot of that leverage, and is now under a great deal of pressure due to the rising cost of health care. Despite spending $3.4 billion in 2003 for health care, CalPERS' costs represent less than 3 percent of the total health expenditures in California. CalPERS covers approximately 1.3 million lives. Of those, approximately one-third or 440,000 are covered by Kaiser. However, Kaiser covers 6.8 million in California alone. In other words, Kaiser members who are covered through CalPERS represent less than 6.5 percent of all Kaiser California members. Even if all CalSTRS members were added to the CalPERS' Kaiser group, it would not be enough to change the balance in the relationship. Although California is the predominant state for managed care, there are 18 California counties without a HMO option available. CalPERS has the reputation as the most hard-nosed, efficient customer in the health care marketplace, but had to accept average increases of 25 percent in health insurance premiums for 2003. Some project that there will be 20 percent increases in premiums next year or changes in benefit plans to increase cost-sharing by the insured participants.

Under SB 461, which was introduced during the last legislative session, but was not enacted, CalSTRS would have been required to provide catastrophic prescription drug insurance for all retired DB Program members. In the report titled "Review of Potential Health Care Benefits Programs Provided by CalSTRS," given to the Legislature in May, 2001, CalSTRS staff reported that it was very difficult to project the costs of such insurance. This is because of the unpredictable prescription drug market, which is caused by a couple of factors. First, individuals age 65 or older use four times as many prescription drugs as people under age 65. As a result, the cost of prescription drugs for retired CalSTRS members could increase more rapidly than for the general public. Second, Medicare doesn't currently cover prescription drugs. If Medicare did establish such coverage, demand for prescription drugs could increase, and the design of the CalSTRS program would have to reflect the design of the Medicare program. In any case, it is reasonable to assume that the cost of catastrophic prescription drug insurance for approximately 155,000 retired DB Program members would be at least $100 million per year and that the insurance would require a high deductible before program payments would begin.

The advantages of CalSTRS being a health care provider include the potential economies of scale from purchasing insurance for a large group. A separate decision would need to be made about whether CalSTRS would or could subsidize the present district cost of health insurance. Currently, CalPERS does not subsidize the cost of the health benefits it provides; such subsidies are the responsibility of the employer of the active member or the employer for whom the retired member worked. In addition, CalSTRS may be able to provide greater access to health care and assist retired and disabled members who must pay their entire premiums for their own health insurance. Members and their families would have more consistent health insurance coverage. Finally, CalSTRS would have a contractual relationship with all providers giving all active and retired members an advocate in health care.

There are many disadvantages to CalSTRS being a health care provider. First, CalSTRS would experience the same problems as CalPERS' present problems, including the need to provide world wide coverage. It would be assuming all the problems that the employers are currently

facing and trying to manage. CalSTRS would be taking on a function that far exceeds its present responsibilities and would have to develop significant expertise and infrastructure, including major database enhancements, all of which would duplicate the expertise and infrastructure already held by CalPERS.

Currently, because each employer decides for itself, through the bargaining process, the design of its health benefits coverage, there is wide variation in the design of health benefits in public schools. Some plans, such as those offered by the Los Angeles Unified School District and the Los Angeles Community College District are comprehensive and, therefore, relatively expensive, providing lifetime coverage to their employees. Many other districts effectively terminate coverage after the retired employee reaches age 65. As a result, it would be difficult to provide a comprehensive plan that is attractive yet affordable for all districts. In addition, individual school districts and their employees would have less control over their health insurance contracts. In order to avoid these problems, CalSTRS could limit its coverage to retired members. Persons age 65 and older are 12.6 percent of the U.S. population, but account for one-third of the nation's annual healthcare expenditures and per capita expenditures for this group are four times as much as for those under the age of 65. As a result, if CalSTRS only provided health benefits for retired members and their dependents, the cost would be prohibitive and probably attractive only for those members who required health benefits that were otherwise unavailable, and usually have relatively high utilization of medical care. This would put further pressure on CalSTRS' health premiums.

If CalSTRS were to assume the role of a health care provider, it also would become subject to increased regulatory requirements. CalSTRS presently does not store or transmit personally identifiable medical information electronically for most of its members. If it offers health insurance, this would change and CalSTRS would have to comply with Health Insurance Portability and Accountability Act of 1996 (HIPAA). In addition, CalSTRS would have to comply with the proposed Governmental Accounting Standards Board ruling about post-employment benefits other than pensions. Compliance with both of these requirements would likely require increased cost and staffing.

Financier of Health Insurance

A second role for CalSTRS is that of a financier of health benefits. As a financier, CalSTRS would completely or partially fund the cost of health insurance, but would not necessarily negotiate coverage or premiums with the carrier. This is the role that CalSTRS plays with the Medicare Premium Payment (MPP) Program, which pays the Medicare Part A premium for eligible DB Program members.

In addition to the MPP Program, there have been legislative proposals in the past that would have expanded CalSTRS' role as a financier of health care. For example, SB 191 from last session would have required CalSTRS to pay the Medicare Part B premiums for all CalSTRS retired members. With approximately 135,000 members age 65 or older, and the present Medicare Part B premium of $58.70 per month, the direct annual cost of this proposal in 2003 would be approximately $95 million. If one assumes an eight per cent increase per year in premiums, the direct annual cost in 2014 would be about $222 million. There would also need to

be an increase in staff and modifications of the database because CalSTRS would have to process approximately 135,000 deductions per month compared to the approximately 11,000 present Medicare Part B deductions. There would be approximately 500 to 600 new deductions each month because that many members turn age 65 each month.

This legislative session, Senator Torlakson introduced SB 147, which requires that CalSTRS to administer a Health Security Account (HSA) Program by July 2005. Districts that voluntarily participate in the HSA Program would contribute funds to CalSTRS to reimburse retired members' allowable medical expenses on a tax-free basis. Although CalSTRS would provide the funds that members would use to obtain health benefits, from contributions paid by employers while the members are working, individual members would be responsible for securing the health benefits purchased with those funds.

The primary advantage of the financier role is that CalSTRS already has expertise in collecting, investing and paying funds. It also has expertise in making deductions from members' allowances if necessary. In addition, there is the possibility of providing increased benefits to members with a potentially more limited exposure to CalSTRS if health care costs should escalate at a greater rate than anticipated.

However, there are also some disadvantages to this role. Funding these programs relies on availability of additional resources. There are no CalSTRS funds currently available for such purposes, and with the budget crisis at state and local district levels, it would be very difficult to secure additional contributions from the state, districts or members for at least the near future. If such funds became available, a determination would have to be made whether using such funds for health benefits would be a higher priority for the Board and CalSTRS members than improved pension benefits. In addition, CalSTRS would, in some cases, be committing the system to future obligations, including regular actuarial studies and increased staffing.

Educator/Advisor about Health Insurance
The third potential role for CalSTRS would be that of an educator or advisor about health care programs. CalSTRS would provide information to assist employers and members on issues that affect their health care programs.

There are a number of advantages to this role. Because CalSTRS already has established relationships with employers, members, and constituent groups and mechanisms designed to share information (such as Employer Information Circulars, Employer Institutes, Regional Counselors, *Bulletin, Retired Educator*, workshops and the CalSTRS Web site), the transition could be easy. In addition, CalSTRS currently is an educator, to a limited degree, in the MPP Program. Health Benefits staff and Regional Counselors assist members, their families or representatives through the Medicare enrollment process. Although CalSTRS staff cannot tell members which, if any, health insurance to purchase to supplement their Medicare coverage, staff do help members in understanding the factors to consider when making that decision. Staff also refer members to the Health Insurance Counseling and Advocacy program (HICAP), which provides excellent service. There are programs available with which CalSTRS could partner to provide information to our members. For example, AARP sponsors the Senior Medication

Awareness and Training Program ($SMAR_xT$), an educational outreach effort to help increase the proper use of medication.

Some of the disadvantages to this role are that CalSTRS has little information about our members' individual health care coverage design, utilization and health status. Thus, education would have to be general rather than focused and directed. In addition, CalSTRS may be duplicating efforts of the members' health insurance carrier. There are also risks because members will have expectations that will be improbable, if not impossible, for CalSTRS to meet. The inability to advise members on specific actions to take could result in legal risks associated with providing information that members perceive as advice, act upon and then blame CalSTRS for adverse impacts.

As an extension of the educator/advisor role, CalSTRS could take the additional step of advising members on health insurance choices. Although additional training would be required, CalSTRS could expand the mechanisms it already uses to share information to provide advice and members have indicated they would like this service. However, this would duplicate other services such as that provided by HICAP. In addition, CalSTRS would need to develop expertise, and keeping information current and relevant for multiple areas would be difficult. There are also legal risks associated with this level of service.

A further expansion of the educator/advisor role would be that of advocate. Specifically, CalSTRS could take a more active role and advocate with the Legislature on bills that affect California educators, even if they are not directly CalSTRS related. Similarly, CalSTRS could become a significant voice in national health policy as it affects retired Americans.

RECOMMENDATION

CalSTRS can play a greater role in the health security of its members and participants, particularly those who have retired. CalSTRS should be cautious, however, that it play a role for which it is suited, and does not subject itself to financial liabilities over which it has limited control or ability to evaluate. Toward that end, staff recommends that CalSTRS expand its role as an educator about health care. This is a service that CalSTRS members have indicated would be useful, and involves less financial risk than other potential roles.

In addition, CalSTRS should continue to play a role as a financer of health insurance to the extent that funds are available. However, the Board should be very selective in the health care programs that it chooses to finance, to ensure that consensus has been reached about the members' acceptance of the program. These roles allow CalSTRS to leverage its expertise in financing and education and provide value to members by enabling informed choices that are potentially less expensive. Finally, because the health care environment is so volatile and the risks are so high, the Board should not become a provider of health benefits.

PRESENT STATE OF HEALTH CARE COSTS

The health care system is in crisis and costs continue to spiral upward both in California and throughout the United States. Many of the efforts, such as managed care, that were supposed to stem those increases are no longer working. Because their costs are rising most rapidly, prescription drugs are the focus of many present reforms. Although there continue to be efforts at both the state and federal level to try to change this trend, it is a complex problem for which there are no easy solutions. A number of facts help better understand the situation.

- The United States is the only country in the industrial west that does not have a form of universal health coverage.
- Health spending in the United States totaled $73 billion in 1970, rising to $1.3 trillion in 2000 and is expected to reach $3.1 trillion by 2013.
- During the 20th century, the average life expectancy of Americans increased three decades. California teachers live longer than the average citizen. So, our members can, on average, plan on living 20 to 30 years in retirement.
- Medicare, the primary health insurance for United States residents age 65 and older, covers less than one half of older adults' expenses for health care.
- Medicine is no longer practiced under an acute care model. Instead, many suffer from chronic conditions for which prescription medication can provide relief. Yet, Medicare does not cover this important part of medical care.
- Over 40 percent of prescriptions are used improperly and approximately $177 billion is spent annually in the United States to treat the effects of medication misuse.
- The cost of prescription drugs has increased 100 per cent over five years.

A number of factors are driving the rapid increases in health care, including:

- Increasing utilization;
- Increased malpractice insurance premiums, as evidenced by efforts at the state and federal level to limit damages and doctor strikes;
- Improved technology;
- A shortage of staff, specifically nurses and pharmacists;
- A shift in costs to other funding sources, including private carriers, as governments lower reimbursement to Medicare and Medicaid providers;
- Increased demand resulting from the advertisement of prescription medication; and
- Mandated coverage of specified services, which increase costs.

In addition to the rising cost of health care, many private employers eliminated retiree health benefits in response to Financial Accounting Standard (FAS) 106 promulgated in 1993 by the Financial Accounting Standards Board (FASB), which provides accounting rules and financial reporting standards for private companies. The percentage of medium and large firms offering retiree health plans to active employees fell from 71 to 41 percent between 1988 and 1993, the year in which FAS 106 became operative. Under FAS 106 companies are required to recognize retiree medical benefits as a form of deferred compensation and to report the present value of these future benefits. Previously, companies had been able to report retiree health benefits on a

pay as you go basis. However, federal regulations do not allow tax-advantage funding for this form of deferred compensation.

Although some school districts offer health insurance to their retired employees, this number is likely to drop if the Governmental Accounting Standards Board (GASB), the equivalent to FASB for governmental agencies, adopts a rule it is considering that is very similar to FAS 106. GASB published the draft for comment of this new ruling in mid-February. Under the proposed GASB standard districts may be required to recognize retiree medical benefits as a form of deferred compensation and to report the present value of these future benefits. Presently, districts can report retiree health benefits on a pay as you go basis. CalSTRS is studying the proposal to determine if it will have any impact on CalSTRS. Because California districts offer a wide range of health benefits for their retired members, each district will need to determine the impact on its own situation.